INDEX

	Page
Opinion below	1
Jurisdiction	1
Question presented	2
Statute and Regulations involved	2
Statement	2
Argument	4
Conclusion	8
Appendix	9

CITATIONS

Cases:

Bennett v. *Commissioner*, 139 F. 2d 961	6
Bingham v. *Commissioner*, 105 F. 2d 971	5
Bowers v. *Kerbaugh-Empire Co.*, 271 U. S. 170	8
Burnet v. *Sanford & Brooks Co.*, 282 U. S. 359	8
Commissioner v. *First National Bank of Commerce of San Antonio, Tex.*, 112 F. 2d 946	5
Commissioner v. *Spreckels*, 120 F. 2d 517	5
Dobson v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231	7
Feathers v. *Commissioner*, 8 T. C. 376	6
First National Bank, Philipsburg, Pennsylvania v. *Commissioner*, 43 B.T.A. 456	5
Haden, W. D., Co. v. *Commissioner*, 165 F. 2d 588	6

Statute:

Internal Revenue Code, Sec. 22 (26 U.S.C. 1946 ed., Sec. 22)	10

Miscellaneous:

I. T. 3548, 1942-1 Cum. Bull. 74	5
Treasury Regulations 103, Sec. 19.22(b)(12)-1	10

In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 94

TRUST COMPANY OF GEORGIA, PETITIONER

v.

MARION H. ALLEN, COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINION BELOW

The opinion of the Court of Appeals (R. 44-46) is reported at 180 F. 2d 527. The findings of fact and conclusions of law of the District Court (R. 34-40) are reported at 84 F. Supp. 944.

JURISDICTION

The judgment of the Court of Appeals (R. 47) was entered on March 2, 1950. The petition for a writ of certiorari was filed on May 29, 1950. The

jurisdiction of this Court is invoked under 28 U. S. C. Section 1254.

QUESTION PRESENTED

Whether taxpayer is entitled to exclude from its taxable income for 1940 a portion of the gain realized in that year on the sale of certain corporate stock which had been acquired in 1932 in full satisfaction of an outstanding debt due the taxpayer, where the fair market value of the stock at the time of such acquisition was substantially less than the amount of the debt but where only a portion of the bad debt loss so suffered was of tax "benefit" in the year in which the debt was liquidated.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code and Treasury Regulations are set out in the Appendix, *infra,* pp. 9-12.

STATEMENT

This is a suit against the Collector of Internal Revenue for the District of Georgia to recover amounts aggregating $44,506.57, plus interest thereon, paid as federal income and declared value excess profits taxes for the year 1940 by the Trust Company of Georgia. The essential facts as stipulated (R. 17-20) and found by the District Court (R. 34-40) are these:

On February 13, 1931, the taxpayer made a loan to Tom Huston Corporation in the amount of $400,000. This loan was secured by 60,000 shares of

the common stock of a subsidiary, the Tom Huston Peanut Company. By January 21, 1932, the Tom Huston Corporation was in bad financial condition and the taxpayer on that date agreed to, and did, take over the 60,000 shares of the common stock of the Tom Huston Peanut Company in full satisfaction and complete cancellation of this debt. (R. 18, 34-36.)

The fair market value of the common stock of the Tom Huston Peanut Company at the time acquired by the taxpayer was $3 per share, or a total of $180,000 for the 60,000 shares. The taxpayer accordingly showed in its income tax return for 1932 that it had sustained a loss of $220,000 on the debt of Tom Huston Corporation. (R. 18.) Taxpayer's net taxable income, apart from the loss on this transaction, amounted to $58,455.37; hence the tax "benefit" realized by taxpayer in that year was said to be limited to that amount. (R. 39.)

In 1935 the taxpayer contributed 12,000 shares of the Tom Huston Peanut Company stock so acquired by it to the latter corporation, and between 1935 and 1940 the taxpayer sold 5,000 shares of the stock to officers of the Tom Huston Peanut Company at a price less than $3 per share. The taxpayer, accordingly, in 1940 still held 43,000 of the 60,000 shares of Tom Huston Peanut Company stock acquired by it in 1932. In 1940, the taxable year here involved, the taxpayer sold these remaining 43,000 shares of stock in Tom Huston Peanut

Company at a price of $12.50 per share, or a total of $537,500. In its income and declared value excess profits tax return for that year the taxpayer reported a capital gain on this sale in the amount of $376,250. (R. 19, 37-38, 39-40.)

This suit is based on the claim (R. 6-12) that the gain realized by the taxpayer in 1940 on the sale of the 43,000 shares of Tom Huston Peanut Company stock was in part a recovery of the loss sustained in 1932, and that since a portion of this loss was of no tax "benefit" to it in 1932 a corresponding portion of the gain realized on the sale in 1940 should be excluded from its gross income in that year. The District Court sustained the taxpayer's contention and entered judgment in its favor for the amount of the refund claimed. (R. 40-41.) The Court of Appeals reversed (R. 47), holding that no part of the gain realized on the 1940 transaction was excludable under the Code provision relied upon (R. 44-46).

ARGUMENT

This case was correctly decided by the court below. The decision is not in conflict with any decision of this Court or of any Court of Appeals, and no grounds are advanced warranting further review.

It was stipulated (R. 18) and found (R. 36) that taxpayer on January 21, 1932, took over 60,000 shares of common stock of Tom Huston Peanut Company, which had been pledged to secure an indebtedness of $400,000, in full satisfaction and com-

plete cancellation of the indebtedness; and that on that date the stock had a fair market value of $180,000. The taxpayer does not deny that it thus suffered in the year 1932 a bad debt loss to the extent of $220,000, the difference between the amount of the debt owed to it and the fair market value of the stock received by it in satisfaction of the indebtedness. That conclusion follows from the decisions of at least three Courts of Appeals and the Bureau of Internal Revenue has so ruled. *Bingham* v. *Commissioner,* 105 F. 2d 971 (C.A. 2d); *Commissioner* v. *First National Bank of Commerce of San Antonio, Tex.,* 112 F. 2d 946 (C.A. 5th); *Commissioner* v. *Spreckels,* 120 F. 2d 517 (C.A. 9th); I. T. 3548, 1942-1 Cum. Bull. 74.

If, as is now well settled, the transaction whereby the taxpayer acquired the stock in complete cancellation of the indebtedness owed to it was such as to constitute the realization of a deductible loss on the indebtedness, it necessarily follows that the transaction was a "closed" one for tax purposes and the acquisition of the absolute ownership of the shares of the stock was the beginning of a new transaction for tax purposes. The Bureau of Internal Revenue has ruled (I. T. 3548, supra) and the Tax Court has held (*First National Bank, Philipsburg, Pennsylvania* v. *Commissioner,* 43 B.T.A. 456) that where property so acquired is subsequently sold, the basis for determining gain or loss is the fair market value of the property at the

date of acquisition. See also *Bennett* v. *Commissioner*, 139 F. 2d 961 (C.A. 8th); *W. D. Haden Co.* v. *Commissioner*, 165 F. 2d 588 (C.A. 5th); *Feathers* v. *Commissioner*, 8 T. C. 376, where the same principle is recognized. There is, so far as we know, no decision holding otherwise, and we do not understand the taxpayer to argue to the contrary.

The taxpayer asserts a right to offset against the gain realized by it in 1940 upon the sale of 43,000 shares of the stock acquired in 1932, the amount of the bad debt loss sustained by it in 1932, which resulted in no tax "benefit" [1] to it in that year. Its position in this respect is based upon the contention (Pet. 6) that it took over the collateral in 1932 only in order to secure more freedom in the management of the "collateral", to which alone it had to look for repayment; that this was for the purpose of preventing further loss, or of recovering its loss, by the ultimate sale of the "collateral"; and that therefore the taking over and holding of the collateral must be integrated with the loan and the ultimate sale. This contention of the taxpayer ignores the fact that in 1932 it became the absolute owner of the

---

[1] Although it is said that the petitioner had no "tax benefit" in 1932 with respect to the bad debt, the meaning of this statement requires analysis. Undoubtedly, taxpayer had numerous other deductions in 1932, and there is no basis for saying that these other deductions were available in full to reduce gross income whereas the bad debt could be applied only against such gross income as remained after the other deductions were made. All the deductions are pooled into a single amount, and it is inaccurate to say that a particular portion of a particular deduction was of no "tax benefit" to the taxpayer.

stock in question; that the stock was no longer held by it as "collateral"; and that there was no longer in existence any indebtedness to be recovered. The court below correctly held, we submit, on the undisputed facts, that the making of the loan in 1931, the acceptance of the stock in 1932 in cancellation of the debt, and the subsequent sale of the stock at a gain in 1940, were clearly not parts of a single integrated transaction.

Dobson v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231, does not support taxpayer's position. That case does not lay down any general principles concerning the integration of a series of transactions into one transaction. Nor does the decision below in this case purport to establish any general rule for integration of a series of transactions; the court below did not deny that in a proper case, where in fact integrated transactions are involved, they may be so treated for tax purposes. In the *Dobson* case the recovery in 1939, which was sought to be taxed, was in settlement of a suit in which the taxpayer alleged that fraud had been practiced upon him when he purchased certain stock; it was in effect a return to the taxpayer of part of his original cost. The intervening deduction for tax purposes, without tax benefit, of that cost was held by the Board of Tax Appeals not to require the adjustment to zero of taxpayer's basis. Here, the income in question was derived from the sale of taxpayer's own property, and did not arise

from a recovery on the original debt. It was not received from the debtor or the debtor's property. It was solely a gain accruing during the period subsequent to the acquisition of the property by the taxpayer.

Bowers v. *Kerbaugh-Empire Co.*, 271 U. S. 170, relied upon by taxpayer, did not involve a transaction such as here presented. That case was distinguished by this Court in *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, which declared the principle, here applicable, that losses of one year may not offset receipts of another year. The other cases relied upon by taxpayer are plainly distinguishable on their facts.

CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.
THERON LAMAR CAUDLE,
Assistant Attorney General.
ELLIS N. SLACK,
LEE A. JACKSON,
FRED E. YOUNGMAN,
Special Assistants to the Attorney General.

JUNE, 1950.

APPENDIX

Internal Revenue Code:

SEC. 22. GROSS INCOME.

* * * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * * *

(12) [As added by Sec. 116 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Recovery of bad debts, prior taxes, and delinquency amounts.*—Income attributable to the recovery during the taxable year of a bad debt, prior tax, or delinquency amount, to the extent of the amount of the recovery exclusion with respect to such debt, tax, or amount. For the purposes of this paragraph:

(A) *Definition of Bad Debt.*—The term "bad debt" means a debt on account of worthlessness or partial worthlessness of which a deduction was allowed for a prior taxable year.

* * * * *

(D) *Definition of Recovery Exclusion.*—The term "recovery exclusion", with respect to a bad debt, prior tax, or delinquency amount, means the amount, determined in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, of the deductions or credits allowed, on account of such

bad debt, prior tax, or delinquency amount, which did not result in a reduction of the taxpayer's tax under this chapter (not including the tax under section 102) or corresponding provisions of prior revenue laws, reduced by the amount excludible in previous taxable years with respect to such debt, tax, or amount under this paragraph.

* * * * *

(26 U.S.C. 1946 ed., Sec. 22.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

Sec. 19.22(b)(12)-1 [As added by T.D. 5288, 1943 Cum. Bull. 103, and amended by T.D. 5454, 1945 Cum. Bull. 68]. *Recovery of Certain Items Previously Deducted.*—(*a*) *In general.* —Section 22(b)(12) provides that income attributable to the recovery during any taxable year of bad debts, prior taxes, and delinquency amounts shall be excluded from gross income to the extent of the "recovery exclusion" with respect to such items. The rule of exclusion so prescribed by statute applies equally with respect to all other losses, expenditures, and accruals made the basis of deductions from gross income for prior taxable years, including war losses referred to in section 127, but not including deductions with respect to depreciation, depletion, amortization, or amortizable bond premiums. (See *Dobson* v. *Commissioner,* 64 S. Ct. 239.) The term "recovery exclusion" as used in these regulations means accordingly an amount equal to the portion of

the bad debts, prior taxes, and delinquency amounts (the items specifically referred to in section 22(b)(12)), and of all other items subject to the rule of exclusion which, when deducted or credited for a prior taxable year, did not result in a reduction of any tax of the taxpayer under Chapter 1 of the Internal Revenue Code (other than a tax under section 102) or under corresponding provisions of prior revenue laws.

(1) *Section 22(b)(12) items.*—The term "section 22(b)(12) items" as used in these regulations means those bad debts, prior taxes, delinquency amounts, and all other items subject to the rule of exclusion, for which a deduction or credit was allowed for a prior taxable year. If a bad debt was previously charged against a reserve by a taxpayer on the reserve method of treating bad debts, it was not deducted, and it is therefore not considered a section 22(b)(12) item. Bad debts, prior taxes, and delinquency amounts are defined in section 22(b)(12)(A), (B), and (C), respectively. A typical example of a delinquency amount described in that section is interest upon delinquent taxes. A typical example of the other items not expressly referred to in section 22(b)(12) but nevertheless subject to the rule of exclusion is a loss sustained upon the sale of stock and later recovered, in whole or in part, through an action against the party from whom such stock had been purchased.

(2) *Definition of "recovery."*—Recoveries result from the receipt of amounts in respect of

the previously deducted or credited section 22(b) (12) items, such as from the collection or sale of a bad debt, refund or credit of taxes paid, or cancellation of taxes accrued. Care should be taken in the case of bad debts which were treated as only partially worthless in prior years to distinguish between the item described in section 22(b)(12), that is, the part of such debt which was deducted, and the part not previously deducted, which is not a section 22(b)(12) item and is considered the first part collected. The collection of the part not deducted is not considered a "recovery." * * *

☆ U. S. GOVERNMENT PRINTING OFFICE: 1980 891727 759